SUPREME COURT, U. S.

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IN THE

Supreme Court of the United States

OCTOBER TERM 1967

No. 1149

In the Matter of

H. S. DORF & CO., INC.,

Bankrupt.

JAMES B. KILSHEIMER III, as Trustee in Bankruptcy,

Petitioner,

—v.—

BEOL, INC.,

Respondent.

BRIEF OF BEOL, INC. IN OPPOSITION TO THE PETITION FOR CERTIORARI

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Statement

After two jury trials in the New York Supreme Court, Beol, Inc., a New York solvent corporation, recovered from H. S. Dorf & Co., Inc., another New York corporation, $53,176 for breaches of contracts of factoring and freight forwarding. Three days after this judgment was entered, H. S. Dorf & Co., Inc. transferred its assets, its customers and its business of 18 years of standing to Dorf International, Ltd., which is still continuing business in New York

* All references are to Petitioner's Separate Appendix. Italics are ours, unless otherwise indicated.

City. Then in 1952 Beol, Inc. sued in the same court said two Dorf corporations for receivership, injunction and an accounting by means of a judgment creditor's plenary bill in equity and Herman S. Dorf personally for damages in aiding said fraudulent transfers under New York Debtor & Creditor Law. Judgment was recovered for $78,681 on February 15, 1960 (*Beol, Inc.* v. *Dorf et al.*, 22 N. Y. Misc. (2) 798; 193 N. Y. Supp. (2) 394) against Herman S. Dorf and relief by said equitable remedies was granted against said Dorf corporations. In subsequent appeals to the Appellate Division, First Department all defendants twice unsuccessfully urged that said recovery should be for the benefit of all creditors of H. S. Dorf & Co., Inc. (12 N. Y. App. Div. (2) 459 and 616) and that such other creditors are not barred by New York Statute of Limitations. Only Herman S. Dorf attempted twice to obtain on the same grounds leave to appeal from New York Court of Appeals, but failed (9 N. Y. (2) 610 and 908). To stay execution on the said money judgment against him, Dorf substituted for his personal liability surety bond of American Insurance Company.

In 1957 Beol, Inc. relying on its original judgment of 1952 filed petition in bankruptcy against H. S. Dorf & Co., Inc. Only after a year elapsed following the entry of said judgment of February 15, 1960 that said Dorf corporation consented to its adjudication May 4, 1961 and trustee was appointed on June 6, 1961.

By order of the Bankruptcy Court of August 23, 1963 the said trustee obtained leave to litigate in the New York Supreme Court. The trustee then applied to said State Court to set aside said judgment of February 16, 1960 in favor of Beol, Inc. for fraud in its procurance, for lack of jurisdiction because it ignored pending bankruptcy proceedings, for failure to relieve all general creditors of said

corporate bankrupt and because the cause of action of Beol, Inc. against solvent Herman S. Dorf vested in said trustee in 1957 and was not barred by the New York Statute of Limitations (39). This application was referred *on the merits* (20 N. Y. App. Div. (2) 686) by Mr. Justice Markewich to hear and report to Special Referee Leo J. Mullen, who took testimony of over 1,500 pages and over 150 exhibits during two years of hearings, and recommended the dismissal of the trustee's contentions. Mr. Justice Markewich concurred and held that under New York Debtor & Creditor Law Beol, Inc. recovered from Herman S. Dorf its money judgment which:

> "* * * was not, therefore, a following of corporate assets (of bankrupt, H. S. Dorf & Co., Inc.), but a direct mulcting in damages of the individual judgment debtor (Herman S. Dorf); *it represents no assets of the bankrupt estate*" (19).

The Appellate Division, First Department unanimously affirmed the order of Special Term denying trustee's said contentions (25 N. Y. App. Div. (2) 820) just as it affirmed twice the opinion of Mr. Justice Wasservogel, who in granting judgment of February 15, 1960 similarly said:

> "It necessarily follows, therefore, that Dorf, as an officer and director of H. S. Dorf & Co., Inc., must be held liable to plaintiff for the money and value of the corporate debtor's assets disbursed by him with knowledge of its actual or impending insolvency" (21-2).

The damage of Beol, Inc. under New York Debtor & Creditor Law was measured by the moneys and value of corporate assets and business fraudulently transferred by Herman S. Dorf. *Liability for such losses is a money damage, and not a following of corporate assets.*

The U. S. District Court for the Southern District of New York (Hon. Walter R. Mansfield) upheld said decisions of the New York courts as binding on the Bankruptcy Court under Full Faith and Credit Clause of the United States Constitution (56-61). The U. S. Court of Appeals for the Second Circuit unanimously affirmed on the same ground (62-63) (see *infra* Point III, pp. 10-13).

Sole Question Involved

Beol, Inc. is a secured creditor of the corporate bankrupt who filed no claim and asks nothing in the bankruptcy proceeding. The trustee does not represent Beol, Inc. but only general creditors, and is not in privy with or is a successor of Beol, Inc. Is there anything in the Bankruptcy Act which would transfer title to the trustee to the interest of Beol, Inc. in the surety bond of American Insurance Company, a bond in which the corporate bankrupt never had any interest, and which was procured and guaranteed by private funds of Herman S. Dorf, a solvent third party, and the only parties to said bond are said surety company, said Herman S. Dorf and Beol, Inc.

Facts

The trustee in his petition omits controlling indisputable facts and erroneously reports others. The correct statement of facts does not appear in the Findings of Fact by the Referee in Bankruptcy and those Findings were rejected by the District Court (61), which made a correct statement of facts in his opinion (34-50).

We will state important facts under the respective points below, and our last Point IV at pp. 14-17, *infra*, indicates some of the most glaring factual digressions from truth made by the trustee in his petition.

REASONS FOR DENYING PETITION:

POINT I

Trustee fails to indicate a single ground for allowance of the petition enumerated in Rule 19 of this Court.

The trustee enumerates eight questions which he wants this Court to review under his petition. Six of these questions deal with alleged errors of the New York State Courts in deciding trustee's applications. The trustee admits that two of such questions were jurisdiction and fraud. He omits to state that two other questions he expressly asked the state courts to decide were his right to the cause of action of Beol, Inc. as an asset of the bankrupt estate and the bar of limitations to recover damages for general creditors under New York Debtor & Creditor Law (see *infra,* Point III at pp. 10-13). Under Full Faith & Credit Clause errors of the State courts may not be reviewed in the Federal courts:

> "A final judgment of a court of competent jurisdiction upon the merits concludes the parties to the litigation and their privies even though the court may have been mistaken as to the facts, or may have misconceived the law" (Providential Development Co. v. United States Steel Corp., 236 Fed. (2) 886).

And see:

> *Miller* v. *National City Bank,* 166 Fed. (2) 723, 726;
> *Clegg* v. *United States,* 112 Fed. (2) 886.

Under Question 7 the trustee claims that property of corporate bankrupt was taken from the bankrupt estate by the decisions below. How due process was violated under Fourteenth Amendment because of the decision, which the trus-

tee briefed and argued we do not understand. Concededly, Beol, Inc. does not hold any property of the corporate bankrupt, and claims nothing from it. Concededly, all that Beol, Inc. seeks are the proceeds of the surety bond, which the corporate bankrupt did not create, and in which it has no assets whatsoever. Concededly, the corporate bankrupt never was nor now is a party to the surety contract. How payment of this bond to Beol, Inc. will deprive the trustee of any assets we do not understand.

The trustee throughout his petition insists that Beol, Inc. recovered against Herman S. Dorf personally under his judgment creditor's bill. This is an intentional misstatement both of the relevant facts and the applicable New York State law.

The judgment creditor's plenary bill in equity requires that the creditor shall have judgment and an execution returned unsatisfied thereon (*Southard* v. *Benner,* 72 N. Y. 424, 426-7; *Buckley* v. *Stanfield,* 155 N. Y. App. Div. 735, 742; *Hayward* v. *Leeson,* 176 Mass. 310). In 1952 Beol, Inc. had no judgment and, hence, no execution against Herman S. Dorf. Beol, Inc. sued him personally for damages caused by his personal fraud under New York Debtor & Creditor Law because it did not require these prerequisites (*American Surety Co.* v. *Conner,* 251 N. Y. 1; *Bernheim* v. *Burden,* 253 N. Y. App. Div. 232, 233), and joined these two actions in one complaint following *Societe Milion* v. *Nat. Bank of Greece,* 281 N. Y. 282. Recovery under such law is strictly limited in New York "to the extent necessary to satisfy *plaintiff's* claim" (Article 276) and see *infra* Point II at pp. 7-10. General creditors now represented by the trustee were not plaintiffs in the 1952 action of Beol, Inc.

Question 1 raises the issue of trustee's rights under the Bankruptcy Act. We will deal with this question under the next point.

POINT II

Trustee acquired no rights to the surety bond under the Bankruptcy Act.

The purpose of the Bankruptcy Act is to take charge of bankrupt's assets and to distribute them equitably to the creditors. Neither Beol, Inc. nor Herman S. Dorf are bankrupts. The trustee seeks to obtain the proceeds of the judgment between them. The Bankruptcy Act does not give him any rights over assets of solvent third parties nor over a judgment between them, procured more than a year before trustee's appointment.

Even over the assets of the bankrupt, the Bankruptcy Act confers on the trustee only limited rights. Thus, the trustee obtains title only to such assets and rights of the bankrupt as he had on the day of the filing of the petition for bankruptcy. If the bankrupt obtains new property after such filing, it is not within his bankruptcy assets. If the bankrupt used his assets to create rights in others, the trustee cannot destroy such rights and reclaim such assets.

a. Bond did not exist when petition in bankruptcy had been filed.

It is conceded that the corporate bankrupt never appealed to the New York Court of Appeals from the affirmance of the judgment of February 15, 1960. Herman S. Dorf attempted to so appeal from so much of said judgment as directed a separate and individual recovery by Beol, Inc. from him of money judgment. To secure the stay of execution on said personal judgment, Herman S. Dorf on December 6, 1960 filed a surety bond of American Insurance Co. secured by his own bonds and stocks, paid its premiums and made it payable to Beol, Inc. None of these assets were

ever in possession or control of nor a title to any of them was ever claimed by the corporate bankrupt.

The petition in bankruptcy of H. S. Dorf & Co., Inc. was filed on September 10, 1957. At that time said bond did not exist. It is settled bankruptcy law that a trustee in bankruptcy obtains title only to such assets, title whereto existed in the bankrupt on the date of said filing.

Mr. Justice Markewich in his opinion said:

> "In short, the original judgment (January 2, 1952) against the now bankrupt corporation has long ceased to be viable, and it has been replaced, so far as the plaintiff is concerned, *by a new fund,* out of reach of the bankrupt estate."

Even if the bond of American Insurance Company were procured by the corporate bankrupt itself three years after filing of the bankruptcy petition, it would not constitute a part of its bankrupt estate. (*Everett* v. *Judson,* 228 U. S. 474, 478-9; *Matter of Baxter,* 104 Fed. (2) 318, 320; *Matter of Penn,* 41 Fed. (2) 257, 259; *Matter of Swift,* 259 Fed. 612, 614, app. dism. 268 Fed. 305; *In Re Home Discount Co.,* 147 Fed. 538, 548.)

b. Bond payable only to Beol, Inc. is not bankrupt's asset.

The bond in question was procured by Herman S. Dorf to meet the New York statutory requirement to stay execution on Beol, Inc.'s judgment for damages against him personally, and is payable solely to Beol, Inc. It is a statutory supersedeas bond. The corporate bankrupt is not a party thereto in any manner.

Even if the bond in question were procured by the corporate bankrupt, it is settled bankruptcy law that pro-

ceeds thereof payable to another are not a part of bankrupt's estate.

In *Matter of Goldsby*, 51 Fed. Supp. 849, the bankrupt filed a statutory bond payable to the Commissioner of Agriculture of Florida. The Referee held that the proceeds were assets of the bankrupt estate. In reversing, the Court, relying on *Betzer* v. *Olney*, 14 Cal. App. (2) 53, 57; 57 Pac. (2) 1376, said at p. 850:

> "[1] Section 110, 11 U.S.C.A., specifies the classes and species of property or other assets of the bankrupt, title to which passes to the trustee for the bankrupt estate. Neither the surety bond of the bankrupt nor the proceeds therefrom, are in any wise embraced within the provisions of said section. Property to which the bankrupt has no ownership right does not become a part of the bankrupt estate. Lynch v. Lentz, D. C., 10 F. 2d 561.
>
> [2] A trustee in bankruptcy can recover only such property as the bankrupt could have controlled and collected personally, at the time when his right passed to his successor. Otis v. Springfield Fire & Marine Insurance Co., 122 Me. 239, 119 A. 612.
>
> [3] Transferability, it is said, determines whether property becomes an asset to the trustee. In re Wright, 2 Cir., 157 F. 544, 18 L.R.A., N.S., 193."

In *Betzer* v. *Olney, supra,* where the bankrupt filed a bond required by the California Corporate Securities Act, the Court held that the proceeds were not bankrupt's assets.

It is probably because of such status of the present bankruptcy law that Mr. Justice Harlan in denying trustee's second application for certiorari said on February 1, 1968:

"Application for reargument denied. My previous disposition rested entirely upon the findings made and conclusions reached by the two courts below, which I consider present no question that would be deemed worthy of review by at least four members of this Court."

POINT III

Trustee is precluded by full faith and credit clause in the Constitution to relitigate the same issue finally decided against him by New York State courts.

In his petition the trustee states that he seeks "an order adjudging that he is entitled to collect * * * the proceeds of a judgment recovered in * * * the New York Supreme Court * * * by Beol, Inc., respondent, against Herman S. Dorf" (at p. 1).

Previously, the trustee asked the same New York Supreme Court to determine the following precise issue:

"(a) that the cause of action upon which the judgment (Beol, Inc. v. Herman S. Dorf) was recovered was and is an asset of the bankrupt estate of the defendant H. S. Dorf & Co., Inc." (39).

The state courts unanimously decided this issue against the trustee, and held that said cause of action and its proceeds belong to Beol, Inc. (25 N. Y. App. Div. (2) 820). Such final order is entitled to the benefit of the rule of Full Faith and Credit (United States Constitution, Article II, Sec. 1) in the federal courts (*Stole* v. *Gottlieb,* 305 U. S. 165; *Puget Sound Electric Ry.* v. *Lee,* 207 Fed. 860; *Steingut* v. *Nat. City Bank,* 38 Fed. Supp. 451).

The District Court in deciding this point in his opinion said:

> "In the present case the trustee, with this Court's authority, intervened as a party in the state court for the purpose of raising a basic issue, and then raised that issue, as against same party * * * The issue was thereupon tried on the merits between the same parties and adjudicated by the state court adversely to him. * * * Having unsuccessfully litigated the issue before the state court, the trustee may not now relitigate it anew in this Court" (52).

The Court of Appeals affirmed, stating in its opinion:

> "We affirm on the ground that, as Judge Mansfield held, the trustee is bound by the result in the state court action to which he made himself a party, with the consent of the bankruptcy court, by voluntary intervention.
>
> "A bankruptcy trustee who by choice or by necessity resorts to a state court for the prosecution of a claim is of course bound by the adjudication made in the state proceeding", Brown v. Gerdes, 321 U. S. 178, 185 (1944) (63).

The question was repeatedly decided by this Court. In *Winchester* v. *Heiskell,* 119 U. S. 450, this Court said at p. 454:

> "The assignee in bankruptcy appeared in the State court and litigated his rights there. This he had authority to do, and the judgment in such an action is binding on him. This we have many times decided. Mayo v. Fritton, 20 Wall. 414; Doe v. Childress, 21 Wall. 642, 647; Scott v. Kelly, 22 Wall. 57; Eyster v. Gaff, 91 U. S. 521; Burbank v. Bigelow, 92 U. S. 179, 182; Jerome

v. McCarter, 94 U. S. 734, 737; McHenry v. La Societe Francaise, 95 U. S. 38; Davis v. Friedlander, 104 U. S. 570."

The proceeds which the trustee seeks are results of a state judgment obtained under the provisions of a state statute, New York Debtor & Creditor law. Under that settled state law, the recovery in such an action is solely for the benefit of the plaintiff creditor and only to extent of his claim. It does not extend to the claims or interests of other creditors of the same debtor (*Societe Milion Athena* v. *Nat. Bank of Greece,* 281 N. Y. 282; *Lazar* v. *Towne House Restaurant Corp.,* 5 N. Y. App. Div. (2) 794; aff'd 6 N. Y. (2) 923; *Gruenebaum* v. *Lissauer,* 185 N. Y. Misc. 718, aff'd 270 N. Y. App. Div. 836). The federal courts are without power to amend the construction of state statutes by the state courts. Said this Court in *Morehead* v. *N. Y. ex rel. Tipaldo,* 298 U. S. 587 at p. 609:

"* * * this New York Act, as construed by her court of last resort, must be taken to express the intention and purpose of her lawmakers."

The trustee claims that he was deprived of the benefit of Mr. Justice Wasservogel's decision under the rule of primacy. First of all that rule does not apply because the main issue, namely the alleged right of the trustee to the judgment of Beol, Inc. was not litigated there [and see other reasons in the opinion of Judge Mansfield (48-50)]. But we fail to see what benefit the trustee could derive by substituting the corporate bankrupt, the only party represented by him in that action. Under the pleadings in that action the trustee could recover nothing either against Beol, Inc. or against Herman S. Dorf, as the corporate bankrupt had no claims and no counterclaims against them. The New

York rule is *secundum allegata et probata.* "The judgment is utterly unwarranted by any thing in the pleadings", said the court in *Wright* v. *Delafield,* 25 N. Y. 268, 270-1 setting it aside.

Of course, the creditors represented by the trustee also may claim damages by reason of Herman S. Dorf's fraud. The total value of assets and goodwill of the corporate bankrupt transferred by Dorf to Dorf International, Ltd. was five times as much as the original judgment of Beol, Inc. recovered on January 2, 1952. All the claims represented by the trustee, other than non payable claims of Herman S. Dorf, as a fraudulent director of bankrupt, amount to $20,000. Thus, if the trustee believes that he is not barred to sue under the New York Debtor & Creditor Law, he has a wealthy bank director, Herman S. Dorf, well solvent to indemnify in full all the remaining creditors of the corporate bankrupt. Dorf's personal fraud is a *res judicata.* His immunity in the bankruptcy proceedings against suit is a mystery to us, and is an outstanding breach of trustee's duties in the bankruptcy proceedings.

Since the decisions below upheld in effect the construction of New York Debtor & Creditor Law by all the New York courts, we cite the decision of this Court in *Birtcher Corp.* v. *Diapulse Corp. of America,* 87 S. Ct. 6 which states:

> "* * * I do not think it is within the realm of reasonable probability that this Court will undertake to reassess the Court of Appeals' view of the local law. In my opinion, the likelihood of certiorari being granted is thus too remote * * *".

POINT IV

Correction of some facts in Trustee's petition.

Page 3, Question 2. Mr. Justice Wassevogel clearly granted to Beol, Inc. money judgment against Herman S. Dorf, and not the return of assets of H. S. Dorf & Co. Inc. as the court well knew that all said assets passed to Dorf International, Ltd. and that said assets were at least three times the amount awarded, which amount represented only the sum due as damages to Beol, Inc.

Page 3, Question 3. Mr. Justice Markewich in his opinion dealt only with the action of Beol, Inc. against Herman S. Dorf (see *supra,* at pp. 3, 8) and not with the combined judgment creditor's bill in equity.

Page 4, Question 4. Trustee's intervention in the state court dealt principally with his claim that the cause of action of Beol, Inc. against Herman S. Dorf under Debtor & Creditor Law belonged to him and that general creditors represented by him were not barred to recover.

Page 6. The state courts could do nothing about the pendency of bankruptcy proceedings, because the U. S. Court of Appeals refused to stay the state trial. *Beol, Inc.* v. *H. S. Dorf & Co., Inc.,* 267 Fed. (2) 319.

Page 8. The order of Referee in Bankruptcy was offered in evidence merely to show trustee's right to intervene, which without the order was subject to dismissal. The state courts decided the claims of the trustee on the merits. *Beol, Inc.* v. *Dorf et al.,* 20 N. Y. App. Div. (2) 686.

Page 10. U. S. Circuit Court of Appeals expressly affirmed on the ground that United States Constitution, Article IV, Section 1 applied.

Page 10, Reason 1. None of the cases cited either deal with a recovery by creditor under New York Debtor & Creditor Law or direct transfer of such recovery to trustee in bankruptcy of debtor.

Page 11. In *Gruenebaum* v. *Lissauer,* 185 N. Y. Misc. 718, which the trustee claims supports him, the court said: "Plaintiff may act in his own right alone" (729), which means that he recovers only sum due him and not anything due to other creditors represented now by the trustee.

Page 13. 3 Collier on Bankruptcy, Par. 63-27, deals with personal actions *against the bankrupt.* Herman S. Dorf against whom Beol, Inc. recovered money judgment is a solvent third party, and had never been and is not now a bankrupt.

Page 13. The trustee states that Mr. Justice Markewich "did not make any finding with regard to any facts" and "hasn't a single fact or point of law to sustain" his opinion. That judge decided on the long report of Referee Mullen which included 1,500 printed pages of testimony and over 150 exhibits and included complete printed record of the trial before Mr. Justice Wasservogel. Briefs were submitted to him including trustee's briefs of over 100 pages.

Page 14. Petition in bankruptcy filed in 1957 was based on the judgment of January 2, 1952, under which Beol, Inc. had no lien, but acquired it in 1960. Waiver must rely on existing and not anticipatory rights.

Page 14. In granting money judgment to Beol, Inc. Mr. Justice Wasservogel did not rely on statutory bar of other creditors, but on provisions of Debtor & Creditor Law, which limit recovery to the plaintiff only (see *supra,* at p. 3).

Page 15. The trustee states that Beol, Inc. "commenced a judgment creditor's action" against Herman S. Dorf. This Beol, Inc. could not and did not do (see *supra,* at p. 6), but commenced against him an action under the Debtor & Creditor Law and recovered damages solely caused to it and not to other creditors.

Page 16. The trustee again attacks Mr. Justice Markewich claiming that his opinions "do not rest upon any pleadings or record" and that "there was total lack of compliance with requirements" necessary in deciding questions relating to res judicata. We pointed out above under Page 13 how untrue are these irresponsible assertions.

Page 17. The trustee asserts that Mr. Justice Markewich "without justification, made the erroneous statement expressing an unfounded principle of law that the judgment creditor's action was not a following of corporate assets." No such statement was ever made by said judge. All he said was that the bond provided by Herman S. Dorf in 1960 was not a part of the assets of corporate bankrupt, who stripped itself of all its assets in 1950 and that the recovery of Beol, Inc. of damages from Herman S. Dorf was under Debtor & Creditor Law and independent of the equitable remedies granted to follow judgment debtor's assets.

Page 17. The trustee accuses the courts below that they applied the Full Faith and Credit provision relying on authorities which "were decided on entirely different facts than those at bar". The cases cited all dealt with trustees who went voluntarily to state courts, lost their cases there and desired to relitigate same issues in the federal courts. Are the facts herein different?

Page 18. The trustee urges "the difference between both proceedings (state and federal) is quite obvious, since in the bankruptcy court the application was not to vacate the

judgment". As Judge Mansfield said this statement "represents a neat bit of sophistry which ignores the purpose and effect of the trustee's actions in both proceedings" (54). In the state court, the trustee required a holding "that the cause of action upon which the judgment of Beol, Inc. against Herman S. Dorf was recovered was and is an asset of the bankrupt estate" (see *supra*, at p. 10), but here he claims "that he is entitled to collect as an asset of the bankrupt estate the proceeds of the judgment" (petition, p. 1). Is there any difference, and is it obvious?

Page 19. The trustee again accuses the courts below in sustaining the rulings of Judge Markewich "based on no evidence or proof" (see Page 13 *supra*) and that Mr. Justice Wasservogel held that the money judgment he granted Beol, Inc. against Herman S. Dorf was not damages for his fraud but "a following of corporate assets" (see Page 17 *supra*). In other words, the trustee contends that after a week of trial, Mr. Justice Wasservogel did not know that all the corporate bankrupt's assets, its business and its good-will passed to Dorf International, Ltd. and there was nothing to follow into the hands of Herman S. Dorf.

We invoke the customary practice of this Court to deny the petition for certiorari for misrepresentation of material facts.

CONCLUSION

That the petition for certiorari should be denied.

Respectfully submitted,

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Dated: New York, N. Y.
March 5, 1968.